

Offshore Energy Law

Operating LNG vessels in Russia

With sanctions against Russia a recurring news item, we consider the significant challenges that sanctions presented to the Yamal LNG project and how they were overcome.

The Yamal LNG project in Russia has provided owners with challenges, both technical and financial, but has enabled them to develop the first ice-class LNG vessels in order to cross the Northern Sea Route, and finance the construction of these vessels in the face of sanctions which effectively removed access to US and European bank financing.

The US, EU and Canada introduced targeted sanctions against Russia following the 2014 Russian military intervention in Ukraine. Other countries, including Japan, Australia, Norway and Switzerland followed with similar sanctions regimes. Sanctions potentially impact any ship being chartered to a Russian company (or a company beneficially owned by a Russian entity) and the financing of that ship. The sanctions target financial services, energy and defence by designating or blocking Russian individuals and entities, limiting access to debt financing for Russian financial institutions, and prohibiting some services and technical support to oil and gas projects.

United States of America

OFAC ("Office of Foreign Assets Control") sanctions prohibit all activity by US persons with persons on the SDN ("Specially Designated Nationals") List and prohibit activities targeted in Directives by US persons on the SSI ("Sectoral Sanctions Identifications") List; this extends to entities owned 50% or more by SDNs/SSIs. A US connection is key as the directives only apply to US persons. A "US person" is a US individual or company organised under laws of the United States; it is unlikely therefore that a non-US company listed in the US would be included simply on the basis of its listing in the US. However, OFAC has viewed any participation by a US person in a transaction as triggering sanctions for all parties. As a

result, the funding of a loan in USD would be problematic, as dollar clearing in the US by a US person could potentially provide the US connection to an otherwise sanctions-compliant transaction. Using Euros as an alternative may only pass the risk to that of a breach of EU sanctions.

Europe

EU sanctions are effective in all EU member states and apply:

- (i) within the territory of the EU,
- (ii) on board vessels or aircraft under the jurisdiction of an EU state,
- (iii) to any EU national,
- (iv) to a company incorporated under the laws of an EU State; and
- (v) to any entity in respect of business done in the whole or any part of the EU.

The energy sector is specifically targeted by restrictions on the export or sale of certain technologies used for deep water oil exploration and production, and a prohibition on providing certain services and the supply of specialised floating vessels for these projects in Russia. The restriction also applies to *"other vessels, the navigability of which is subsidiary to their main function"*. This should not however include vessels used for transportation only.

What to do

A charter entered into by a ship owner with a Russian charterer should have extensive sanctions provisions to deal with the impact of a potential sanctions event. Sanctions events should cover, at least, sanctions by the US, the EU, the UK and the country of jurisdiction of incorporation of the owner and its parent company, which make it unlawful for the owner to perform the charter, for the owner's shareholders to own shares in the owner or for the owner's financier to make the loan available.

Initial consequences of a sanctions event occurring would be the suspension of the charter and a deemed force majeure event; hire would continue to be payable and a consultation period to restructure the charter and/or the owner's shareholding should take place to allow a future lawful performance of the charter. If neither the charter restructure or owner restructure are successful, the charterer would usually have options to novate the shipbuilding contract/purchase the vessel or terminate/suspend the charter (and pay a termination/suspension fee).

A full due diligence is the starting point for a lending bank considering financing a vessel chartered to a Russian project and should involve identifying potentially applicable sanction regimes, by reference to the borrower, the borrower's shareholders, the flag of the vessel, the location of operation of the vessels and the project/charter counterparties. Software is available to conduct name-screening exercises on relevant sanctions lists and this should be used as part of the due diligence process. Ultimately legal opinions should be obtained in relation to the relevant sanctions regimes.

Loan documents should be drafted to include undertakings not to use the vessel or loan proceeds in any way to directly or indirectly benefit a restricted party, as the likely result would be a security party or finance party being in breach of sanctions, or a security party or the vessel being exposed to legal proceedings related to sanctions.

Conclusion

In summary, sanctions against Russia have a broad scope and can impact ship chartering and finance transactions directly or indirectly. Even without the direct involvement of restricted parties, indirect involvement is possible with almost every energy-related transaction in Russia. A full due diligence process should therefore be undertaken and the charter and finance documents carefully drafted to deal with the consequences of a sanctions event occurring.